

ST 97-7

Tax Type: SALES TAX

Issue: Machinery and Equipment Exemption - Manufacturing

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

TAXPAYER,)	
)	CLAIM FOR CREDIT
Taxpayer)	
)	Docket No.
v.)	
)	
THE DEPARTMENT OF REVENUE)	John E. White,
OF THE STATE OF ILLINOIS,)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: David A. Hughes, Horwood, Marcus & Braun, Chtrd., Chicago, for taxpayer. John Alshuler, Special Assistant Attorney General, for Illinois Department of Revenue.

Synopsis:

The Illinois Department of Revenue ("Department"), issued a Notice of Tax Liability to TAXPAYER ("TAXPAYER" or "taxpayer") after determining that TAXPAYER owed Retailers' Occupation Tax ("ROT") measured by the gross receipts it received from its retail sales of tangible personal property to purchasers for use in Illinois. TAXPAYER paid the tax, and then claimed a credit for that portion of tax measured by proceeds TAXPAYER claimed should have been deducted from its taxable gross receipts. During the audit, the Department disallowed the claimed deductions.

The matter proceeded to hearing in June 1996. The issue presented was whether TAXPAYER supported its claim for credit by introducing documentation to support its claim that the proceeds from transactions identified thereon should have been deducted from its taxable gross receipts. I am including in this

recommendation findings of fact and conclusions of law. I recommend the issue be resolved in favor of taxpayer.

Findings of Fact:

1. Taxpayer is a Wisconsin corporation engaged in the business of manufacturing, selling, installing and repairing cranes used in industry. Department Ex. No. 2, pp. 10 (Audit Questionnaire), 15 (Audit Narrative).
2. After an audit of taxpayer's business, the Department determined that taxpayer's business activities in Illinois imposed upon it the obligation to collect Illinois use tax, and pay Illinois retailers' occupation tax on the gross receipts it received from purchasers of the tangible personal property TAXPAYER sold for use in Illinois. Department Ex. No. 2, pp. 1-10 (Audit History Worksheet), 11-14 (Audit Questionnaire).
3. The tax to which TAXPAYER claims a refund was measured by the gross receipts TAXPAYER received from the following transactions:

- * a 11/87 sale of 2 cranes to Steel Products, Inc.
- * a 10/16/89 sale of 2 cranes to Corp.
- * a 5/10/89 sale of 1 crane to Sales, Inc.

Department Ex. No. 1, pp. 7-14 (Claim and partial attachments thereto).

4. Taxpayer did not collect any Illinois use tax from its customers regarding those transactions. Department Ex. No. 1, p. 8; Department Ex. No. 2, p. 12.
5. During an audit of taxpayer's business, taxpayer made available to the Department's auditor exemption certificates TAXPAYER obtained from the purchasers of tangible personal property TAXPAYER sold for use in Illinois. For each of the three transactions identified above, taxpayer provided the auditor with an exemption certificate signed by the purchaser. Each certificate identified the name and address of TAXPAYER and the Illinois purchaser, each described the tangible personal property TAXPAYER sold to the purchaser, and each included the purchaser's certification that it was

engaged in the business of manufacturing and wholesaling or retailing, and that it would use the property purchased to manufacture property for sale by it. Department Ex. No. 2, pp. 24 (certificate signed by agent for XXXXX), 26-27 (certificates signed by XXXXX and XXXXX Sales, Inc., respectively).

6. At hearing, the Department did not identify any information required by statute to be included on a manufacturing machinery and equipment ("MM&E") exemption certificate that was not included on the certificates regarding the transactions at issue.¹
7. The only defect the Department complains of on the face of the three exemption certificates is that they were prepared and dated after the date of the transactions they identify. Department Ex. No. 2, p. 17 (Audit Narrative); Tr. p. 12; Department's Brief, (unnumbered) pp. 5-6 (counting cover sheet as page 1 of the memorandum).
8. After taxpayer presented the certificates for audit, the Department's auditor "verified their validity" by contacting the Illinois purchasers to inquire how the purchaser was using the cranes. *See, e.g.*, Department Ex. No. 2, pp. 2-3 (9/24/91 entry) (Audit History Worksheet).
9. After those contacts, the auditor determined that the purchasers who had given taxpayer exemption certificates regarding the transactions at issue were not using the cranes in an exempt manner. *See, id.*, pp. 2-3 (6/25/91, 8/26/91 and 9/10/91 entries).
10. The auditor determined that each such certificate had been issued in error, he informed each purchaser that he determined the transactions were taxable, and he directed those purchasers to withdraw the exemption certificate each purchaser had already signed and tendered to taxpayer.

¹. To prevent awkwardness, I will occasionally refer to the transactions as being at issue, although the only aspect of the transactions in dispute is whether ROT was properly measured by the proceeds TAXPAYER received from such transactions.

Id., pp. 2-3 (9/24/91 entry), p. 4 (10/8/91 entry), p. 7 (1/29/92 and 2/7/92 entries).

11. The auditor disallowed the deductions taxpayer claimed for the gross receipts taxpayer received from the transactions at issue. Department Ex. No. 2, pp. 2-10.
12. The Department issued a Notice of Tax Liability ("NTL") in which it assessed ROT on taxpayer's taxable gross receipts, including those receipts taxpayer realized from the transactions identified in the exemption certificates. Department Ex. No. 1, p. 3.
13. After receiving the NTL, taxpayer paid the tax and filed a claim for credit for the ROT assessed on the gross receipts from the transactions identified in the exemption certificates. Department Ex. No. 1, pp. 3, 7-14.
14. The Department denied taxpayer's claim, Department Ex. No. 1, pp. 5, 15-16, and taxpayer protested that denial. *Id.*, p. 6.

Conclusions of Law:

When taxpayer sold the cranes to the Illinois purchasers in 1987 and 1989, section 7 of the Retailers' Occupation Tax Act ("ROTA") provided, in part:

To support deductions made on the tax return form, or authorized under this Act, on account of receipts ... from any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction, and such other information as may be necessary to establish the nontaxable character of such transaction under this Act.

* * *

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable.

During the same period, section 2 of the ROTA provided, in part:

A tax is imposed upon persons engaged in the business of selling tangible personal property at retail at the rate of 5% of the gross receipts from such sales of tangible personal property made in the course of such business, excluding, however, from those gross receipts, ... (d) the proceeds from the sale of machinery and equipment which will be used by the purchaser, or a lessee of the purchaser, primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease

... The purchaser of such machinery and equipment who has an active resale registration number shall furnish such number to the seller at the time of purchase. The purchaser of such machinery and equipment and tools without an active resale number shall furnish to the seller a certificate of exemption for each transaction stating facts establishing the exemption for that transaction, which certificate shall be available to the Department for inspection or audit.

Ill. Rev. Stat. ch. 120, ¶ 441 (1987) (emphasis added) (now 35 ILCS 120/2-45 (1996)).

The issue in this case is whether TAXPAYER supported its claim that the proceeds from the transactions at issue were deductible from its taxable gross receipts. The yardstick by which taxpayer's claim should be measured is the documentation taxpayer presented to support the claimed deductions. In this case, that documentation primarily consists of the exemption certificates that TAXPAYER tendered to the Department for audit, and which were admitted as evidence at hearing.

The rule in Illinois is rather straightforward. Exemption certificates which, on their face, establish the exempt nature of specific transactions are to be accepted as *prima facie* evidence that the proceeds from the transactions identified thereon were not part of the retailer's gross receipts subject to ROT. Hess, Inc. v. Department of Revenue, 278 Ill. App. 3d 483 (5th Dist. 1996); American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d 93 (5th Dist. 1982); Rock Island Tobacco v. Department of Revenue, 87 Ill. App. 3d 476 (3d Dist. 1980). What is critical for a retailer, therefore, is to insure that any exemption certificate contain -- on the face of the document itself --

whatever information is required by the particular statute to establish the exemption. A Department auditor's decision to accept an exemption certificate that, on its face, contains facts and information necessary to support a particular claim of deduction, while rejecting another certificate that does not, is a principled (not a specious) decision. See American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d at 102 (court upheld the Department's disallowance of deductions for transactions claimed to be for resale where the exemption certificates taxpayer tendered did not satisfy statutory requirements of § 2c (sales for resale)).

Here, the Department does not argue that the certificates fail to identify, on their face, either the basis for the claimed deduction from taxable gross receipts, or whatever other information is necessary to document the claimed deductibility of those proceeds. The Department, for example, does not argue that taxpayer, and not the purchasers, signed the certificates. Nor does it claim that the certificates fail to describe the transactions (and thereby, the gross receipts) at issue.²

The only irregularity the Department complains of is that the certificates were prepared after the transactions were made. It argues that since taxpayer received the exemption certificates after the dates on which the transactions were made, taxpayer never relied on those certificates when deciding not to

². A common example of documentation which fails to identify the transactions or proceeds claimed to be deductible would be an undated or post-dated blanket resale certificate. A blanket resale certificate is one in which the purchaser certifies that all tangible personal property being purchased from the retailer on and after a certain date is being purchased for resale by the purchaser. When accompanied by the purchaser's reseller's registration number, such a certificate would support claimed deductions from taxable gross receipts, but only with regard to proceeds from transactions made on or after the date the certificate was signed.

So, for example, if a retailer's business were being audited for the period 1/1/95 through 12/31/95, and the retailer produced an undated blanket exemption certificate, or one dated 6/1/96, that certificate would not identify any transactions made or proceeds realized during the applicable period. Such documentation would not, on its face, support any claimed deduction from the retailer's taxable gross receipts for the period at issue.

charge Illinois ROT on the transactions. In such a case, the Department asserts, a retailer must establish that the tangible personal property sold was, in fact, used by the purchaser in an exempt manner.

At first, taxpayer appeared to accept the Department's assertion when it agreed that the issue to be determined at hearing was whether the cranes TAXPAYER sold qualified for the ROT's MM&E exemption. See Order dated 12/13/95. That facile statement of the issue, however, substitutes the relevant inquiry for one on which a retailer could ordinarily never prevail. American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d at 103 (holding that no certificate could purport to convey all facts necessary to establish the exempt use, and no retailer could ordinarily undertake to prove how another party used property once it was out of the retailer's possession or control). An exemption certificate is the documentary evidence a retailer is required to make available for Department inspection or audit to support its claim that the proceeds from the transactions identified in the certificates should be deducted from the retailer's taxable gross receipts. See, e.g., Tri-America Oil Co. v. Department of Revenue, 102 Ill. 2d 234, 240 (1984) ("Section 2c ... provides a method whereby a seller can avoid paying a retailers' occupation tax on sales it makes to others, sales which might otherwise be taxable as retail sales even though they may not in fact be retail sales."). Such documentation, however, is not probative of whether the purchaser, in fact, used the tangible personal property in an exempt manner.

In Rock Island Tobacco Co., the resale certificates the Department's auditor refused to accept were, like the certificates admitted into evidence here, obtained by the retailer after the date the transactions were made. Rock Island Tobacco Co., 87 Ill. App. 3d at 477. The court, however, ruled the Department was required to accept the certificates as *prima facie* evidence supporting the deductions from taxable gross receipts, because the certificates contained the information required to be documented so as to establish the

nature of the transactions claimed to be exempt from ROT. *Id.*, at 479. Contrary to its argument at hearing, the Department has informed other retailers that they could obtain after-acquired manufacturing machinery and equipment exemption certificates to document claimed deductions from retailer's taxable gross receipts. Private Letter Ruling 90-0368, p. 6 (June 6, 1990). Finally, the ROTA does not require a retailer to show that it relied on the facts set forth in a purchaser's exemption certificate. In sum, I reject the Department's argument that the exemption certificates taxpayer obtained and presented here have no *prima facie* evidentiary value.

After receiving the exemption certificates from taxpayer in this case, the auditor looked beyond the face of the documents to "verify their validity." Department Ex. No. 2, pp. 1-10. The validity of an exemption certificate, however, is to be verified from the face of the document itself. American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d at 102; Rock Island Tobacco v. Department of Revenue, 87 Ill. App. 3d at 479. If the document is valid on its face, the retailer does not have to shoulder the additional burden of proving the purchaser used the property purchased in an exempt manner. Hess v. Department of Revenue, 278 Ill. App. 3d at 487 ("The overall regulatory scheme with respect to exemption certificates necessitates a finding that the underlying purchaser is more capable of bearing the burden of knowledge of use of the materials purchased pursuant to an exemption certificate."); see also Klein Town Builders, Inc. v. Department of Revenue, 36 Ill. 2d 301, 304 (1967) ("The primary liability [for use tax] is on the person who purchases for use [in Illinois], and the seller's failure to collect the tax cannot operate to discharge the purchaser's liability.").

All I conclude here is that the Department auditor's determination that the certificates were issued in error cannot be held against TAXPAYER. The exemption certificates obtained and presented by TAXPAYER for audit were signed by the purchasers regarding the transactions and gross receipts at issue, and

those documents are regular and valid on their face. TAXPAYER performed the acts the General Assembly deemed sufficient to support the claimed deductions from taxable gross receipts.

Conclusion

The three exemption certificates TAXPAYER obtained and tendered at audit satisfied its burden to support, with documentation, its claim that the proceeds from the transactions identified on those certificates should have been deducted from taxpayer's gross receipts subject to ROT. The Department improperly disallowed those claimed deductions, and taxpayer paid the tax the Department assessed on the proceeds from the transactions at issue.

I recommend the Director reverse the Department's tentative denial of taxpayer's claim, and direct the Department to issue a credit memorandum to taxpayer in the amount of its claim, plus statutory interest.

Date

Administrative Law Judge